

The Level of Corporate Transparency among the World's Largest Multinational Companies

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ABSTRACT

In its recent study, Transparency International (TI) evaluated the level of public disclosure among the 105 largest publicly listed multinational companies (MNCs).

Two out of three evaluated dimensions - organisational transparency and country-by-country reporting - are important to trace how money is generated and how it flows within large multinational corporate structures. Such information should be available to all stakeholders, especially to the citizens of countries, in which such companies operate, bid for licences, sign governmental contracts, generate revenues and pay or not pay taxes.

The study shows several interesting results. First, the average level of organisational transparency is relatively high, but often limited to the disclosure of material fully-consolidated holdings. Second, country-by-country reporting of financial data is still very rare among MNCs. Third, there are already some "best practice examples" - companies, which decided to voluntarily introduce country-by-country reporting for all countries, in which they operate. Fourth, the often quoted argument, that country-level reporting is not possible in some "difficult environments" is not defensible, because one can find examples of good disclosure in almost each such country.

KEYWORDS

Multinational companies (MNC), country-by-country reporting (CBCR), organisational transparency (OT), corporate transparency, Transparency International Secretariat (TI), civil society organisation (CSO)

INTRODUCTION

Transparency International (TI), the global coalition against corruption, has been addressing the issue of corporate transparency for many years. At the beginning its efforts were focused on companies' anti-corruption programmes, but with time a much broader spectrum of issues was taken into account.

TI's engagement in the sector analysis of oil and gas companies and its cooperation with the Extractive Industries Transparency Initiative (EITI) and with the Revenue Watch Institute, resulted in the inclusion of new important transparency-related topics into the agenda: organisational transparency (OT) understood as disclosure of subsidiaries and minority holdings and country-by-country reporting (CBCR) of basic financial data. Both areas were incorporated in the transparency evaluation tools used in TI's private sector studies.

After successful launches of two reports on oil and gas sectors (2008, 2011), TI applied similar criteria to the evaluation of a cross-industry sample of 105 largest publicly-listed multinationals. This resulted in a publication of the report *Transparency in Corporate Reporting: Assessing the World's Largest Companies*, (TI, 2012). The report included company rankings and some analysis of the results.

Data collected by TI for this report is a unique, valuable and publicly available source of information on 105 MNCs. Even if the number of companies is not impressive, the meaning and scope of the study is strengthened by the fact that these are the largest by market value, multinational publicly-traded companies, plus data was collected on a group level and such groups usually include hundreds of consolidated subsidiaries. TI estimates the joint market value of evaluated companies to be more than US\$11 trillion, and their presence to reach out to almost all countries of the world (TI website). What is also important, a big part of data was validated by evaluated companies, which confirmed its quality.

In this paper, this publicly available database is used to illustrate the current level of transparency regarding MNCs' organisational transparency and country-level operations. These two complementary dimensions are the key to understand where money is generated and how it flows within large multinational corporate structures.

TI MEASUREMENT OF CORPORATE TRANSPARENCY

“Transparency is a characteristic of governments, companies, organisations and individuals of being open in the clear disclosure of information, rules, plans, processes and actions” (TI, 2009). This definition is very broad and not really helpful for practical applications. Therefore, for the purpose of measurement it has to be translated into practice.

In case of corporate transparency, the first necessary step is the selection of required information to be disclosed by companies. This is not an easy task, considering an immense range of data collected by companies: financial, organisational, marketing, social, technical, environmental, etc. Companies possess information, which could be of interest to diverse parties, such as owners, lenders, society, governments, civil society organisations (CSOs) or competitors. Some stakeholders can require disclosure of information, which they consider relevant, using laws, regulations or even their authority or financial influence. Other stakeholders are fully dependent on voluntary disclosure of information. In its studies on corporate transparency, TI decided to focus on information, which it considered most relevant for the prevention of corruption, and which is (or has been until recently) disclosed on a voluntary basis. This resulted in the selection of three areas: anti-corruption programmes, organisational transparency and country-by-country reporting.

Not only information disclosed by companies could be bottomless, but also the number of potential sources, in which such information could be found. A company can provide information through its corporate website, stock exchange reporting systems, industrial associations, ministries, municipalities or even through internet pages, which do not seem relevant for such reporting. Corporate information can be publicly available, protected by password or only accessible for selected audience, free of charge or subject to fees, virtual or printed on paper. The number of combinations is immense and makes comprehensive research almost impossible. Without defining a very precise and limited set of sources, practical data collection would not be possible. In its research, TI decided to follow two basic rules. First, information must be publicly available without limitation by fees or passwords - every member of the society should be able to access it. Second, a company’s website should be the source of information, either directly or through attached or linked documents.

The third methodological element added by TI is company consultations on collected data. This process should not affect equal treatment of companies, regardless of their engagement in the process. It should only help identify mistakes and omissions of the researchers, and increase companies’ understanding and acceptance of the transparency requirements. In

fact, the cooperating companies are more likely to follow TI's recommendations and increase the level of their public disclosure, than companies, which do not participate in the data validation process.

The three-dimensional evaluation of corporate transparency has been already applied by TI several times: in 2008 and in 2011 in the *Promoting Revenue Transparency* reports on oil and gas companies (TI, 2011), in 2012 in the *Transparency in Corporate Reporting: Assessing the World's Largest Companies* report (TI, 2012), which is the major subject of this paper, and currently in several running reports (with country, emerging markets and global focus respectively). Each study brings some new experience resulting in modifications of the methodology. The evaluation criteria become more precise and in some cases stricter.

ORGANISATIONAL TRANSPARENCY and COUNTRY-BY-COUNTRY REPORTING

For the purpose of this paper, two out of three corporate transparency dimensions evaluated by TI have been analysed: organisational transparency (OT) and country-by-country reporting (CBCR).

The requirement to publish such data has been first raised by Richard Murphy, whose original idea was to introduce a new international accounting standard for all MNCs, which would require disclosure of information on:

- all entities that form an MNC, their locations and operations,
- sales in each country of operations divided into external and intra-company sales,
- value added, profit and tax by each entity in each country of operations.

The major purpose for such disclosure was defined as follows: "(...) to provide information that will assist those seeking to appraise the organisation with regard to: its corporate social responsibility, investment risk, tax risk, its contribution by way of value added to the societies in which it operates, its contribution to national well-being by way of tax payment within those locations"(Murphy, 2003).

This last aspect - contribution to development through tax payments - is most frequently stressed by organisations supporting international development. In its analysis of "ill-gotten money" in Malawi and Namibia, the World Bank named tax evasion, next to corruption, "the most critical criminal activity impacting development" (WB, 2011). The 2011 UN study

confirmed negative impact of illicit money flows on economic growth, moreover it estimated, that commercial activities such as mispricing, transfer pricing or fake transactions, generate cross-border “dirty money” flows, which are twice higher than those generated by criminal activities (UNODC, 2011). In other words, UN estimates that MNCs conduct more illicit international transactions than smugglers, drug, arms and human traffickers all together.

The idea of corporate transparency, especially through CBCR, has spread fast, leading to the emergence of numerous international initiatives, such as Tax Justice Network, Publish What You Pay or EITI. Recently it moved one step further and reached the legislators in the USA (Dodd Frank Act) and in the EU (EU Directive 2013). Both civil society movements and regulators stress the corporate social responsibility and developmental aspects and they mostly focused on the extractive sectors.

Although the initial idea treated OT and CBCR as two complementary elements, which should be required from MNCs, the second element has attracted much more attention from both CSOs and the legislators. TI’s corporate transparency evaluations put both elements back on the agenda.

HOW MUCH DO MNCs DISCLOSE

In the analysed 2012 TI study, the evaluation of MNCs’ organisational transparency was based on a short questionnaire, which asked about the disclosure of companies’ material entities, both majority and minority owned. For each such entity, a company was expected to disclose: name, country of incorporation and percentage held by the mother company.

The average results were good, but differed strongly among regions and industries (Figures 1 and 2 – brown bars – “basic TI questionnaire”). The sample average was 72% (on a scale from 0 to 100%, where 100% means the full disclosure).

Most regional representations were too small to draw any broader conclusions, but the Northern American (mostly US) and the European subsamples were big enough to allow for some comparison. The average score for Europe was 92%, while the average score for the US was only 52%. Most US companies reported only on their fully consolidated holdings (subsidiaries), as required by the SEC regulations. There was hardly any voluntary reporting on minority holdings among the US MNCs. In Europe, on the contrary, reporting on minority

holdings was almost complete, just as reporting on fully-consolidated holdings.

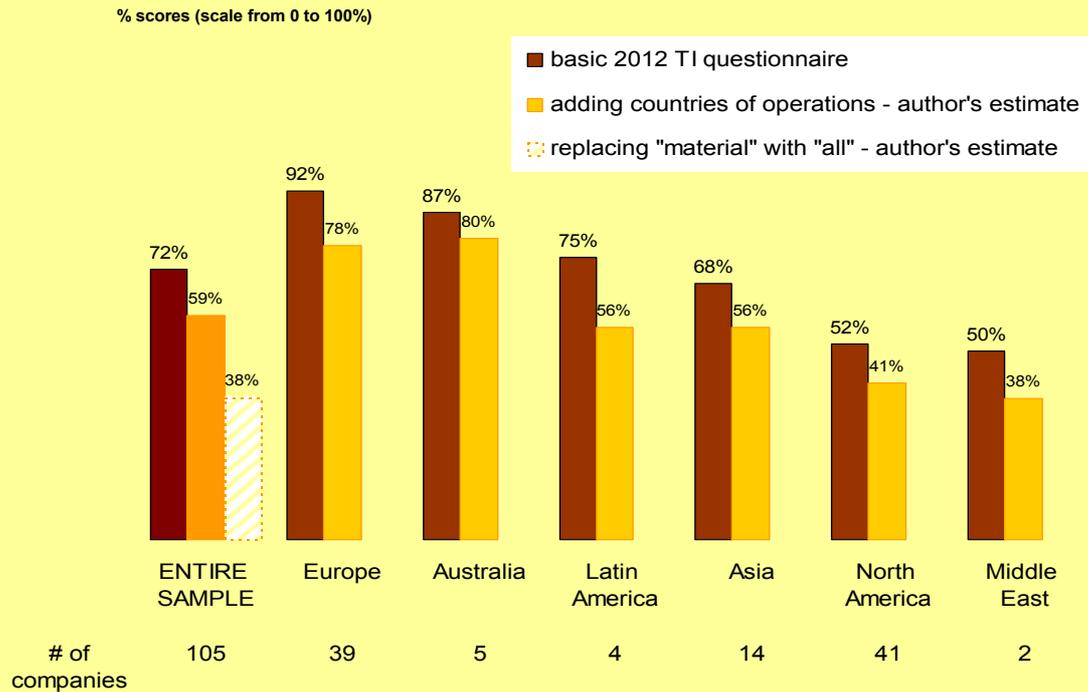
Industry-wise, the sample was too diverse and the subsamples too small to allow for far reaching conclusions. The only bigger subsamples were: oil & gas, financials and consumer goods & services. Among these three, oil & gas achieved the highest scores, which could be related to the longer history of transparency evaluation in this sector and to the existence of industry-specific transparency initiatives.

Initially TI prepared a broader questionnaire for OT evaluation, but it was reduced during the report writing process for methodological reasons (TI, 2012). The questions, which were omitted in the final evaluation asked about countries, in which companies' subsidiaries and other entities conduct their operating business (countries of operations). The author of this paper tried to review corporate documentation to make a rough estimation of what the average results would look like, if the requirement to disclose countries of operations for each group entity was added to the TI questionnaire (Figure 1 and 2 – orange bars). The average result would decrease to 59% and the drop would be similar across regions and industries, because only very few companies disclose such data.

Another exercise performed by the author was to estimate how the results would look like, if the requirement was not only to publish material entities, but to publish all entities, without applying the materiality criterion. The estimated average would be as low as 38%, roughly half of the result calculated by TI.

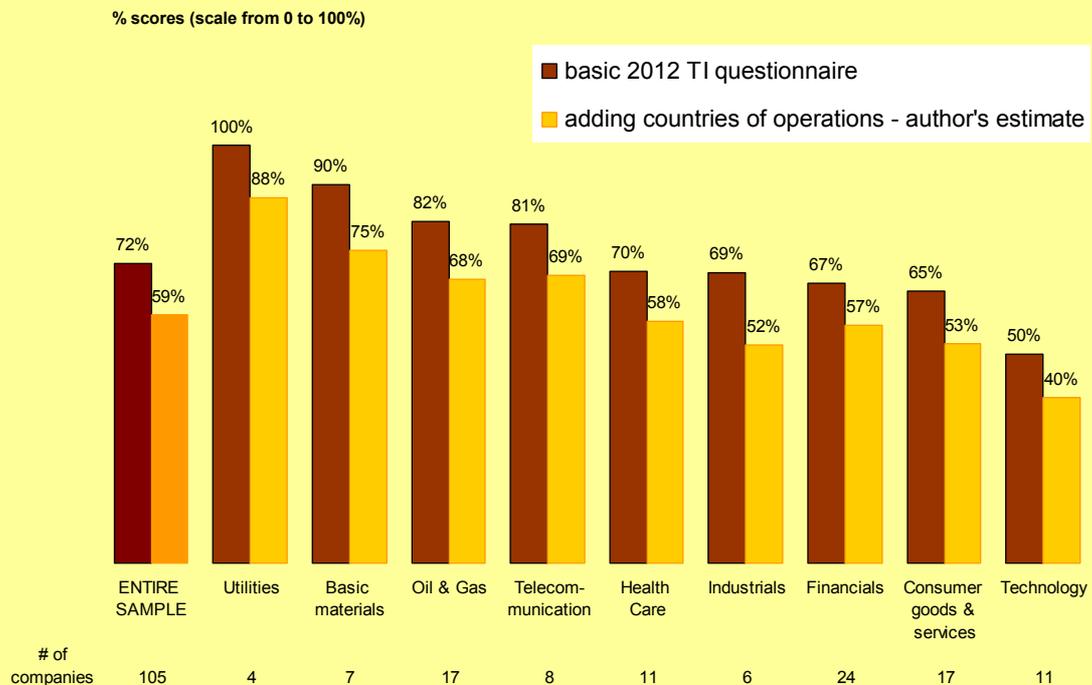
The materiality criterion strongly limits disclosure of group entities, because “material” are only those holdings which are big enough in relation to the whole group. Large MNCs often control several hundred subsidiaries, while on their lists of “material subsidiaries” there are no more than some tens of entities. In the most extreme cases, we find a list of three entities for a group that reports to have 275 subsidiaries (Canon Inc.).

Figure 1: Organisational transparency among largest MNCs: by geographical region



Source: Compiled by the author, data extracted from TI, 2012 and author's estimates

Figure 2: Organisational transparency among largest MNCs: by industry



Source: Compiled by the author, data extracted from TI, 2012 and author's estimates

In its 2012 report, TI evaluated the level of CBCR was by checking country-level disclosure of five elements: revenues, profit before taxation, income tax, capital expenditure and community contributions. The first four elements should give orientation about company's scope of operations in a country, but also about the level of taxation in relation to revenues or profits (an indication of potential tax exemptions or tax evasion). The last required element, although financial, is more related to company's anti-corruption programme, because community or charitable contributions make companies vulnerable to corruption and can serve as its substitute.

The evaluation followed the rule that information about each country in which a company operates is equally important. If a company operates in 100 countries, disclosing data for one of them will always contribute 1% to the overall score, no matter if this is the largest or the smallest country. Additionally, not to allow for home-country bias, results were calculated for foreign operations only. Otherwise, a rather common split of financial data between domestic and international operations would favour countries operating in few countries against countries operating globally.

The results showed a very poor level of CBCR among the largest MNCs. The average result was 3,7% on a scale of 0-100%. In other words, the average CBCR is close to none (Figures 3 and 4).

The average result of the European companies (5,7%) was four times higher than that of the Northern American ones (1,4%). Still, both results were very low.

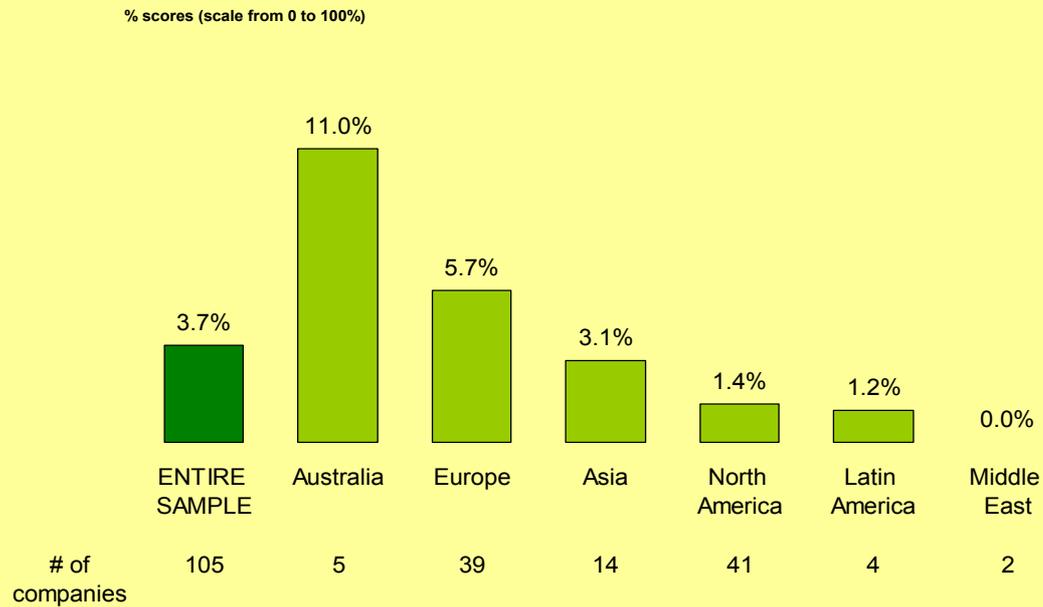
A small subsample of Australian companies was the only regional group achieving a result above 10% and this was primarily thanks to the two basic materials/ oil & gas companies, which achieved high scores of 24%.

It is interesting to note that Statoil, a state controlled Norwegian oil & gas company, was an unchallenged leader with the score of 50%. This confirmed the engagement of the Norwegian government in many transparency initiatives, such as EITI or PWYP.

Another interesting observation on the geographical front is a very high score of the Indian companies. In India, companies are required to attach simplified financial statements of all their subsidiaries (not limited by the materiality criterion) to their annual reports. For publicly listed companies, it means the disclosure of such data to the public. While there is still a difference between subsidiary-by-subsidary reporting and CBCR (bigger subsidiaries often operate in more than one country), TI decided to consider such disclosure as a good proxy

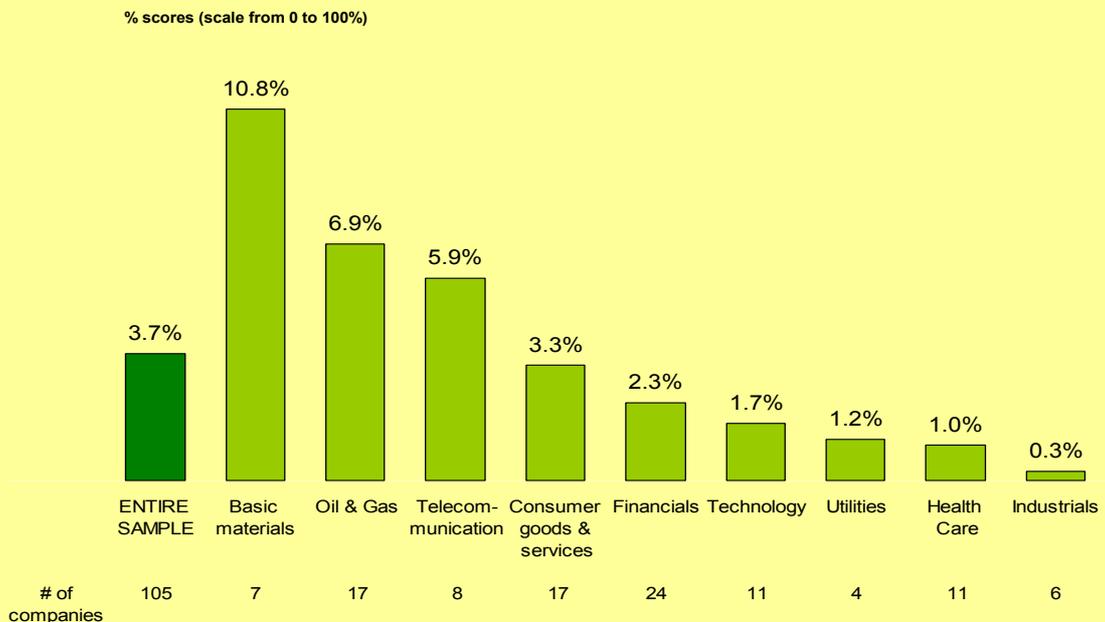
for CBCR, and awarded positive but reduced scores for such reporting (TI, 2012). High Indian scores are therefore a product of high reporting requirements in this country.

Figure 3: Country-by-country reporting among largest MNCs: by geographical region



Source: Compiled by the author, data extracted from TI, 2012

Figure 4: Country-by-country reporting among largest MNCs: by industry



Source: Compiled by the author, data extracted from TI, 2012

Industry-wise, basic materials and oil & gas companies achieved the highest, above-average scores (Figure 4). Most probably, this is a result of long-lasting promotion of the CBCR idea among extractive companies. TI published two reports with such evaluation of oil & gas sectors before applying it to a cross-industry sample (TI, 2011). EITI or PWYP both focus on extractive industries. The recently adopted legislative changes also focus on extractives, and they may have induced some changes in company reporting standards in advance.

WHY IS THE LEVEL OF COUNTRY-BY-COUNTRY REPORTING SO LOW?

What drives secrecy and what supports openness? Who would profit from better CBCR and who would lose? Why does it have to be such a battle to make companies disclose country-level information?

In his paper on political economy of CBCR, Dariusz Wójcik presents a very interesting discussion of how different groups perceive the necessity of such reporting and why they support it or not. He bases his analysis on the results of the EU consultation on CBCR. Generally, groups which strongly oppose CBCR are: companies, accountants and auditors. Groups which are in favour of CBCR are users of such information, mostly represented by CSOs. Other potential users of such information – investors, were hardly engaged in the EU consultation process. Governments neither strongly supported, nor opposed the CBCR (Wójcik, 2012a).

This type of analysis is very valuable, because it helps identify potential supporters of CBCR, as well as, identify arguments, which could convince the opponents. Below, the companies', investors' and governments' attitudes to CBCR are discussed in more detail.

COMPANIES

Most companies oppose CBCR, even in its limited version proposed by the EU. TI experienced similar companies' attitude while conducting its research. Their often repeated arguments were: high costs of generating such information and the so called "difficult environment" – one hard and one soft argument (TI, 2011, TI 2012).

The costs of generating country-level data must be estimated separately by each company

and only such estimation can be used as a valid argument. However, there are two facts, which suggest that such costs cannot be as high, so they could harm companies' competitive position. First, there are companies which regularly publish country-level data and they can bear the associated costs voluntarily, without being rewarded for it. Second, companies report to the tax authorities in all countries, in which they have consolidated subsidiaries, meaning that they have country-level financial data in their records, and it only needs to be compiled and published.

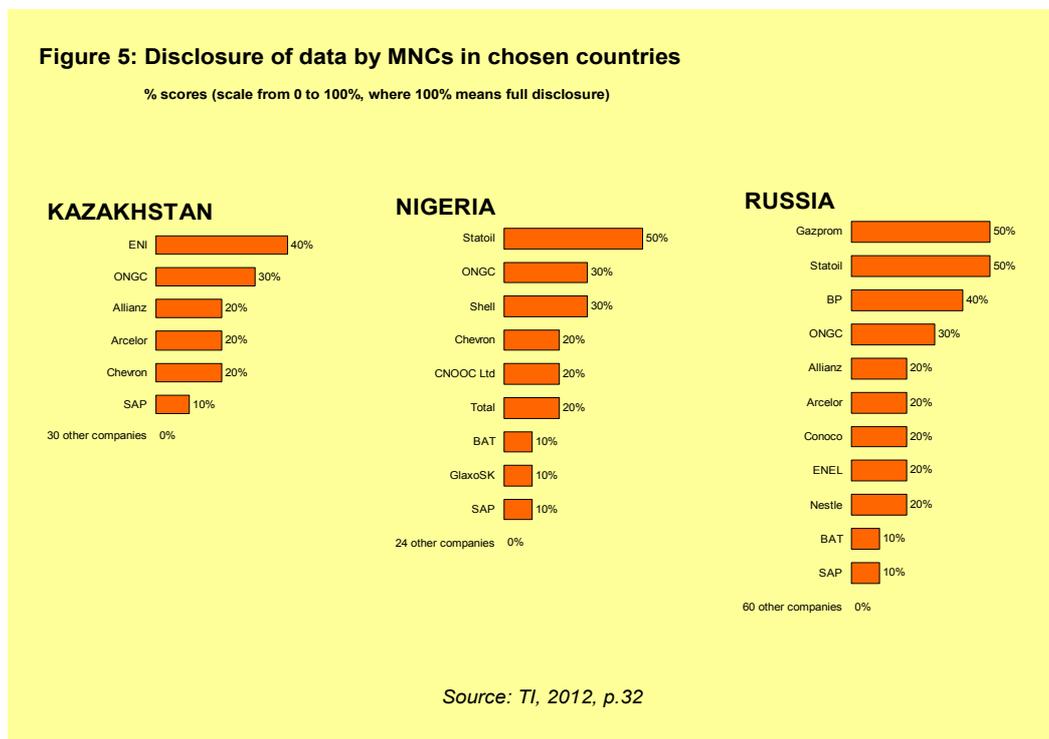
In its impact assessment of different CBCR options in 2010, the EU ordered initial cost estimation for different types of such reporting and on this basis it rejected the full-CBCR option and accepted the option, which required companies to report on payments to governments only (Wójcik, 2012b). However, considering the differences between the accepted and the rejected standards, the biggest differing cost factor was the auditing requirement and not the content of disclosed data. Additionally, as Wójcik noted in his paper, the thresholds of acceptable costs set by the EU in this assessment were chosen arbitrary (Wójcik, 2012b).

The so called "difficult environment" means that in some countries there is high level of secrecy, hence strong opposition from their authorities against disclosure of any data, which could reveal state licences, payments to governments or other elements of contracts between MNCs and local authorities. Companies claim that they could lose contacts, tax exemptions or other favourable treatment if they published data on their operations in certain countries. In other words, they see openness as competitive disadvantage and as a potential reason of lost business.

This particular argument was analysed by TI in its two reports (TI, 2011 and TI, 2012). Both reports confirmed that in each country, no matter how opaque and difficult its political situation is, one can find companies which do not fear openness and disclose country-level data. In the 2011 report on oil and gas sectors, TI compared disclosure by different transnational oil and gas producers in oil-rich African, Asian, Latin American and CIS countries. Since the report was industry-specific, we can find evidence that direct competitors chose different levels of openness in the same environment. For example in Equatorial Guinea, three US oil and gas producers: Marathon, Hess and ExxonMobil disclosed 54%, 23% and 8% of required data respectively. Another example is Kazakhstan, where Italian Eni disclosed 92% of required information, while BG, Chevron and BP only 8%, and ExxonMobil

and Shell disclosed no information at all. The situation repeats through all analysed regions and countries (PRT, 2011, pp.37-39). The same exercise was repeated in the 2012 report and showed similar results (Figure 5). In each country, there are at least several MNCs, which disclose considerable financial data on their operations, while the majority of companies choose to disclose no data at all.

Such results seem to support the thesis, that the “environment” itself is not the real reason for limited disclosure and a company can always decide if to disclose country-level information or not.



The most supportive of the CBCR idea are the extractive companies (Wójcik, 2012a), which confirms the results of the 2012 TI study and supports the statement, that transparency initiatives have the power to change companies' attitude.

INVESTORS

Why don't investors support CBCR? There is no evidence that they oppose it, however their absence in the EU consultation process suggests little interest in the issue. More information should be always in their interest, because it allows for better analysis of risk and for better

forecasting.

First, individual investors are not organised and therefore their opinion not heard. Additionally, they rarely make investment decisions on the basis of their own analysis. They rather buy recommendations, through the usage of investment advisors or they follow official ratings or valuations by professional analysts.

Second, big and influential institutional investors such as investment funds or asset management groups, who do require good information from companies, usually have better sources of such information than publicly disclosed documents. They have direct access to companies - they can ask company's CFO or an investment banker working for a company and making its due diligence for the emission prospectus. Moreover, institutional investors would tend to prefer such exclusive information, because it gives them a competitive edge against other investors.

Considering the above, there might be little use in convincing investors of the benefits of public CBCR, unless the official rating agencies start using CBCR data for their evaluation. If official ratings were affected by the very availability of such data (transparency risk) investors would put pressure on companies to be more transparent.

Therefore, in the battle for CBCR, rating agencies could be a better ally than the investors.

GOVERNMENTS

There are only few governments, which show their commitment to the corporate transparency idea. The Norwegian government supports CBCR through financing of numerous transparency initiatives and it confirms its commitment through Statoil's reporting. Another supportive government is the Indian one. Indian companies are required to report their financials by subsidiary, which is a proxy of CBCR. They also disclose information about countries of incorporation and percentages held in all their subsidiaries, which leads to a high level of OT among them.

Home countries of the largest MNCs are mostly highly developed economies - 80 out of 105 companies in the TI 2012 sample were domiciled in Western Europe, USA or Canada. In many such countries, there is a conflict between MNCs' lobby, which opposes CBCR and CSOs, which support the initiative. The strong pressure from both sides on the governments is most likely going to lead to the compromise solutions, such as the recent legislative changes in the USA and in the EU, which only include chosen industries and limited data.

However, even such compromises are steps in the right direction.

In the host countries of MNCs, especially in the developing world, the support for CBCR will be dependent on the quality of democratic institutions. On the one hand, more transparency contributes to economic development and therefore it should be supported by the host governments. But on the other hand, transparency can also disclose corruption or special tax benefits awarded to MNCs without legal authorisation. The fact, that still only few developing countries support good corporate reporting suggests that host country governments do not see their interest in such transparency.

CONCLUSION

Public disclosure of MNCs' global holdings (organisational transparency), and of their country-level operations (country-by-country reporting) are two important elements of corporate transparency. Such information would, among others, allow for companies to be held accountable to the societies in which they operate with regard to taxation and social responsibility issues.

In its private sector studies, Transparency International evaluated the levels of such transparency among large global corporations. The results allow for drawing the following major conclusions:

1. THE LEVEL OF CORPORATE TRANSPARENCY AMONG MNCs IS STILL LOW

The average results calculated in the TI 2012 report indicate a relatively high level of OT and a very low level of CBCR. However, a closer analysis shows that both OT and CBCR require major improvements.

Although the average level of OT among the largest publicly-listed MNCs is relatively high, it differs strongly between the European and the Northern American companies. While Europe-based companies disclose relatively complete information on both their majority and minority holdings, American companies tend to disclose only majority-owned entities.

Moreover, most companies, regardless of the region, limit their OT disclosure by using the so called "materiality criterion" and they leave out all entities, which are not large enough in relation to the whole group. The disclosure of all entities as opposed to "material only" is

legally required in very few countries. This has led to the general acceptance of such limitation as an unofficial standard, which in practice often means, that companies do not disclose their holdings registered in the offshore financial centres.

Country-by-country reporting among the largest MNCs is very low. In the TI report, even the best performing industrial group, basic materials, scored on average only 10.8% from 100% possible. The best performing company in the whole sample, Norwegian Statoil, disclosed only 50% of information required by the TI's methodology.

2. TRANSPARENCY INITIATIVES DO WORK

The results indicate that the support of home governments or legislators can drive CBCR and OT. Such support can be expressed either through direct regulatory requirements (India – both OT and CBCR), or through the support of global transparency initiatives (Norway - CBCR).

Also the activity of international CSOs brings results (EITI, PWYP), which can be seen in higher levels of transparency in the extractive sectors. CSOs can also succeed in their efforts to change legislation (Dodd-Frank Act, recent EU Directive).

3. NONE OF THE OFFICIAL ARGUMENTS AGAINST CBCR HAS BEEN SERIOUSLY PROVEN

There is little evidence that CBCR leads to competitive disadvantage for companies. The arguments of too high costs of generating such data or host-country difficulties, which could harm companies' competitive position, have never been seriously proven by the transparency opponents.

In 2009, the Norwegian TI Chapter conducted a survey among Norwegian companies about corruption. The most interesting result was the answer to the last question of this study "What are the most important causes of corruption in Norway?" The cause most often chosen by companies was "greed", while the one considered as least important was "it is necessary for doing business" (TI Norway, 2009). It would be interesting to find out if the question "What is the most important reason of low corporate transparency?" asked among MNCs, would give similar results.

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